



**STATE BOARD OF EQUALIZATION
STAFF LEGISLATIVE BILL ANALYSIS**

DRAFT

Date:	06/25/12	Bill No:	Senate Bill 12
Tax Program:	Business Taxes	Author:	Corbett
Sponsor:	Author	Code Sections:	Commercial Code Division 6
Related Bills:		Effective Date:	01/01/13

This analysis will only address the bill's provisions which impact the State Board of Equalization (BOE)

BILL SUMMARY

Among other things, this bill repeals and re-enacts certain provisions of the Bulk Sales Law (BSL) so that a right to payment from the seller's inventory and equipment of a business would be limited to certain "claimants," including specified "licensees."

ANALYSIS

CURRENT LAW

Bulk Sales Law. Under existing law, Division 6 (commencing with Section 6101) of the Commercial Code (CC) establishes a process for a business to make a sale, not in the ordinary course of the seller's business, of more than one-half of the seller's inventory and equipment. The bulk sale provisions also apply in the case of an auction or a sale or series of sales conducted by a liquidator. In general, the BSL provides the following:

- Specifies the conditions that must exist for the BSL to apply.
- Enumerates sixteen different exclusions from the BSL.
- Details the responsibilities of the buyer, including the notice requirements.
- Explains the specific provisions for a "cash" sale of \$2 million or less, including the responsibility of the buyer or escrow agent to apply the cash consideration.
- In cases where claims may be filed with an escrow agent, provides a process to deposit, hold, and distribute the consideration according to specified priorities.
- Describes the consequences to the buyer in the event that a sale fails to comply with the BSL; primarily, that the buyer is liable to a claimant for damages in the amount of the claim.
- Indicates a statute of limitations for an action against a buyer.
- Specifies an effective date that the BSL would apply to a bulk sale.

Definitions:

"Bulk sale" is defined as either (a) a sale by auction or a sale or series of sales conducted by a liquidator on the seller's behalf, a sale or series of sales not in the ordinary course of the seller's business of more than half of the seller's inventory and equipment, or (b) in all other cases, a sale not in the ordinary course of the seller's

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business of more than half the seller's inventory and equipment, as measured by value on the date of the bulk sale agreement.

"Claimant" means a person holding a claim incurred in the seller's business, except for the following:

- a. Claim for employment compensation that is unsecured and unmatured.
- b. Claim for injury to an individual or property, or for breach of warranty, unless certain specified conditions are satisfied.
- c. Claim for taxes owing to a governmental unit if notice is given in accordance with the BSL, and if there is a specific statute that permits or requires notice of the bulk sale to be given to the governmental unit.

"Claim" means a right to payment from the seller, whether or not the right is reduced to judgment, liquidated, fixed, matured, disputed, secured, legal, or equitable.

Sales and Use Tax Law. Under existing law, Revenue and Taxation Code (RTC) Sections 6811 through 6815 (Payment on Termination of Business and Successor's Liability), the purchaser is required to withhold sufficient monies from the purchase price to cover any amount of taxes due unless the former owner produces a receipt (Certificate of Tax Payment) from the BOE showing that the tax has been paid or a certificate stating that no amount of tax is due. Otherwise, the successor becomes liable for payment of the amount, to the extent of the purchase price valued in money.

PROPOSED LAW

Among other things, this bill repeals and re-enacts certain provisions of the BSL so that a right to payment from the seller's inventory and equipment of a business would be limited to certain "claimants," including specified "licensees." In general, the bill amends the current BSL as follows:

- Defines "bulk sale" to no longer apply to sales by auction or a series of sales conducted by a liquidator, but does expand the definition to also include the equipment and inventory purchased from a "licensee."
- Changes the definition of "claimant" to mean any person holding a claim described in paragraphs (1) to (5), inclusive, of subdivision (b) of CC Section 6106.4 incurred in the seller's business or a "licensee" holding a claim incurred in the seller's business.
- Adds the term "licensee," to mean a person licensed as a distributor or wholesaler under the Alcoholic Beverage Control (ABC) Act, or a person licensed as a wholesaler or distributor under the Cigarette and Tobacco Products Licensing Act.
- Revises the exclusions from the BSL, including by deleting the exclusion for the sale of assets that have a value less than \$10,000 or more than \$5 million.
- Amends the notice requirements of the buyer so that notice must be provided of every bulk sale that meets the revised definition of a bulk sale. Requires that the notice provide the name and address of the escrow agent with whom claims may be filed and the last date for filing those claims.
- Deletes the specific provisions applicable to a "cash" sale of \$2 million or less,

and specifies that it is no longer the responsibility of the buyer, but the escrow agent, to apply the cash consideration. Further specifies that the escrow agent's responsibility to each claimant is only to those who filed timely claims.

- Deletes the provisions describing the consequences to the buyer for failure to comply with the BSL, and the related statute of limitations for actions against the buyer.
- Specifies that the re-enacted provision of the BSL applies if the bulk sale agreement is on or after January 1, 2013.

This measure would amend the BSL so that a right to payment from the seller of a business's inventory and equipment would be limited to certain claimants. The claimants are either a "licensee" holding a claim incurred in the seller's business, or any person holding a claim described in paragraphs (1) to (5), inclusive, of subdivision (b) of CC Section 6106.4 incurred in the seller's business.

CC Section 6106.4, subdivision (b), paragraphs (1) through (5), describes the other class of claimants as follows: (1) all obligations owing to the United States, to the extent given priority by federal law; (2) secured claims, including statutory and judicial liens, to the extent of the consideration fairly attributable to the value of the properties securing the claims and in accordance with the priorities provided by law. (a secured creditor may participate in the distribution pursuant to this subdivision only if a release of lien is deposited by the secured creditor conditioned only upon receiving an amount equal to the distribution); (3) escrow and professional charges and brokers' fees attributable directly to the sale; (4) wage claims given priority by Code of Civil Procedure Section 1205; and (5) all other tax claims.

BACKGROUND

The BOE's Sales and Use Tax Department has utilized RTC Sections 6811 through 6815 (Payment on Termination of Business and Successor's Liability) to require the seller/predecessor and purchaser/successor of a business to address a sales and use tax liability owed by the seller. The purchaser is required to withhold sufficient monies from the purchase price to cover any amount of taxes due unless the former owner produces a receipt (Certificate of Tax Payment) from the BOE showing that the tax has been paid or a certificate stating that no amount is due. Otherwise, the successor becomes liable for payment of the liability, to the extent of the purchase price, valued in money. The "Certificate of Tax Payment," or Tax Clearance, is normally handled through escrow and, in most cases, is a condition of the escrow. The process is a proactive effort on the part of the seller to make available to the BOE the proceeds of the sale of the business. In those cases where the purchaser or seller fails to produce a Certificate of Tax Payment, or the purchaser fails to withhold the amount of the liability, to the extent of the purchase price in money or property or providing for the assumption of liabilities, then the law extends to the purchaser of a business the liability of the seller. This is known as successor's liability.

There are times when a business is sold in an arms-length transaction in which the parties retain an escrow company to hold funds in trust pending the satisfaction of the conditions of the sale. In other cases, the parties may not utilize a third party and may deal directly with each other, where they may or may not make use of a contract. The parties may or may not take the assumption of tax liability into consideration and reduce the purchase price by a corresponding amount. In other instances, some businesses

are transferred between related parties (non-arms-length transactions) in an effort by those parties to avoid payment of taxes. In these cases, the parties fail to comply with the statutory provisions that require the seller or purchaser of the business, or the related transferee and transferor, to satisfy the tax liability that has been imposed on the predecessor business.

COMMENTS

1. **Sponsor and Purpose.** This bill is sponsored by the author and is intended to help small businesses in California by “revising the BSL so that a buyer of another business’s inventory will not be faced with the 40 hurdles to determine if they, the buyer, is acting in good faith.”
2. **The revised definition of a “claimant” appears to include the BOE.** As described previously, a claimant is either a “licensee,” as defined, holding a claim incurred in the seller’s business, or any person holding a claim described in paragraphs (1) to (5), inclusive, of subdivision (b) of CC Section 6106.4 incurred in the seller’s business. Additionally, CC Section 6106.4 continues to provide for the priority of payment for competing tax claims, including amounts owed to the BOE. Moreover, the definition of a “bulk sale” seems to have been expanded, to include the inventory and equipment purchased from a “licensee.”

In discussing the bill with the author’s office it appears the intent of the June 25, 2012, amendments was to re-enact only certain provisions of the BSL to apply only to those wholesalers and distributors licensed under the ABC Act or the Cigarette and Tobacco Products Licensing Act. If the bill were to be amended to reflect the author’s intent – limit the provisions of the BSL to apply only to specified wholesalers and distributors, then the BOE shares the concerns of the Assembly Revenue and Taxation Committee bill analysis¹ that, to the extent that fewer sales are processed through escrow companies, it may affect the number of Certificate of Tax Payments requested and paid to the BOE, which could affect the amount and/or timing of the revenues collected by the BOE.

3. **The BSL and the successor liability statutes provide the BOE with two opportunities to collect the tax.** Those businesses that are sold and use the escrow process as described in the BSL provide the BOE with a predictable and cost effective means to collect a claim (tax liability). Typically the escrow company involved in the business sale would contact the BOE to obtain a Certificate of Tax Payment, since the seller would either need to demonstrate that no sales tax amounts are due, or would make available to the BOE the proceeds of the sale of the business. The BOE views the escrow process as the first opportunity to collect the tax – with respect to a business sale, this is an initial opportunity to collect from the seller.

In the event the seller and purchaser complete the business sale outside of escrow, and the seller fails to obtain a Certificate of Tax Payment, then it is the responsibility of the purchaser to withhold sufficient monies from the purchase price to cover any amount of taxes due. Otherwise, the purchaser becomes liable for payment of the amount, to the extent of the purchase price valued in money. The successor liability represents the second opportunity to collect the tax.

¹ Assembly Revenue and Taxation Committee bill analysis, SB 12 (Corbett, 2012): [SB 12 Senate Bill - Bill Analysis](#)

4. **The BSL provisions do not supersede the successor liability statutes.** There is sufficient case law that establishes that the successor statutes are independent of and are not inferior to any remedies available under the BSL; accordingly, the BOE is not required to comply with the BSL to collect a liability of a seller. (See *Schnyder v. State Board of Equalization* (2002) 101 Cal.App.4th 538.) The court noted in its decision that “Practical choices must be made, and successor liability is a factor to consider. Successor liability statutes exist so that the transfer of a business asset cannot be used to evade the payment of taxes.” (*Id.* at 549.) Of additional importance, the court stated that “nowhere in the language of section 6811 is bulk sales mentioned.” (*Id.* at 549-550.)
5. **Other amendments to the BSL may increase the number of businesses affected by the BSL.** As briefly noted in the Proposed Law section of this analysis, this bill amends subdivision (c) of CC Section 6103, which deletes the exclusion from the BSL for the sale of assets that have a value less than \$10,000 or more than \$5 million. Although the bill seemed to narrow the number of businesses that would be subject to the BSL, it could be argued that with the deletion of the \$10,000 and \$5 million threshold, it will actually increase the number of business sales subject to the BSL.
6. **Opponents argue that, if the bill were further amended and limited to only the specified “licensees,” there would be no direction on how to prioritize payments for other types of businesses.** Current provisions of the BSL, CC Section 6106.4, subdivision (b), specifies the priority of payments as follows: (1) all obligations owing to the United States, to the extent given priority by federal law; (2) secured claims, including statutory and judicial liens, to the extent of the consideration fairly attributable to the value of the properties securing the claims and in accordance with the priorities provided by law; (3) escrow and professional charges and brokers’ fees attributable directly to the sale; (4) wage claims given priority by the Code of Civil Procedure Section 1205; (5) all other tax claims; and (6) all other unsecured claims pro rata, including any deficiency claims of partially secured creditors.

Although the order of priority is given, the statute only seems to give general guidance as to what extent they are given priority, as with the case of federal obligations and secured claims. The BOE believes there are existing statutes that provide the guidance necessary to make these existing determinations, including Civil Code Section 2897, Government Code Section 7170.5, federal law, and cases that establish the principle of “the first in time is the first in right.” Should the BSL be further amended to apply only to specified “licensees,” the BOE would expect that the distribution of consideration for other types of businesses sold through an escrow process would be administered consistent with the existing statutory guidance.

COST ESTIMATE

This measure would not affect the BOE's administrative costs.

REVENUE ESTIMATE

In its current form, this bill does not seem to either reduce or significantly add to the collection of revenues when a business is sold and the seller owes a tax liability.

Based on discussions with BOE collection staff, it is our understanding that most of the business sales in which the BOE received a distribution from an escrow company involved the sale of a business, which typically includes assets and consideration other than the inventory and equipment, as currently defined in the BSL. As such, it is the BOE staff opinion that many of the purchasers and sellers were performing due diligence in proceeding through an escrow transaction (and, therefore, providing the BOE with notice of a pending sale), not because they were seeking to comply with the BSL, but rather because they are seeking to avoid the potential of a successor's liability.

For the fiscal years 2010-11 and 2011-12, the BOE received an average of \$16.5 million in revenues from approximately 2,500 demands into escrow (Certificate of Tax Payments). Any revenue impact would be based on a percentage of those collections which would not now be immediately brought to the BOE's attention through escrows. However, other statutes authorize the BOE to hold a successor liable for unpaid amounts by the predecessor business.

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